

House Natural Resource Committee

Reauthorizing the CFTC: Stakeholder Perspectives

Thursday, July 25, 2024

Witnesses:

- [Walter Lukken](#), President and Chief Executive Officer, Futures Industry Association, Washington, D.C.
- [Thomas Sexton](#), President and Chief Executive Officer, National Futures Association, Chicago, IL
- [Travis Antonsen](#), Senior Vice President, Grain Marketing and Logistics, Agtegra Cooperative, Aberdeen, SD
- [Alexandra Thornton](#), Senior Director, Financial Regulation, Center for American Progress, Washington, D.C.

Highlights:

Witnesses placed emphasis on strengthening the CFTC, and protecting customers as well as further expanding tools to support customers, including farmers.

General Notes:

Walter Lukken, CEO of Futures Industry Association, expressed his support for reauthorization, emphasizing the importance of good governance and congressional approval of the CFTC's mission.

He outlined the several points for reauthorization:

- Market Trends and Benefits:
 - Growth: Trading volume on CFTC-regulated exchanges has doubled since 2008.
 - Post-Crisis Reforms: Expanded CFTC regulation of derivatives, enhancing market and financial system safety.
 - Resilience: Markets have remained stable during recent stress events like COVID-19, the Ukraine war, and high inflation, thanks to the CFTC's principles-based regulatory regime.
- Oversight Needs:
 - Emerging Products: Increasing acceptance of cryptocurrencies and digital asset platforms, with concerns over collapsing the multi-tiered ecosystem and its impact on customer protections.

- US Bank Capital Proposals: Potential cost increases for market users due to higher capital requirements for client clearing.
- Jurisdictional Issues: Ensuring no impediments to market access or overlapping issues between the CFTC and SEC.
- Reauthorization Approach:
 - Advocated for a straightforward reauthorization bill.
 - Suggested three minor adjustments:
 - Legislative fix for legal uncertainties around FCM bankruptcies and customer property definition.
 - Expanding CFTC funding for farmer education on derivatives.
 - Supporting legislative efforts for CFTC's research and development flexibility.
- Conclusion
 - Reaffirmed the strength of the current CFTC regulatory framework.

Thomas Sexton, President and CEO of the National Futures Association (NFA).

The NFA is a self-regulatory organization for the derivatives industry, partnering with the CFTC.

- NFA's Role:
 - NFA works with the CFTC to regulate derivatives markets and protect retail customers.
 - They focus on prosecuting trading abuses and fraud.
- Customer Protection in FCM Bankruptcies:
 - Advocated for strengthening customer protections during FCM bankruptcies.
 - Supports amending the Commodity Exchange Act to clarify CFTC's authority to ensure customers have priority in case of fund shortfalls.
- Digital Asset Commodities:
 - Discussed NFA's role in regulating firms dealing with digital asset commodities.
 - NFA supports legislative efforts to govern digital asset markets and is ready to assist the CFTC in developing regulatory frameworks.
- Conclusion:
 - Emphasized the importance of customer protection in reauthorization.
 - Expressed willingness to continue supporting the CFTC's regulatory efforts.

Travis Antonsen represents AG Tegra, a cooperative owned by 6,700 farmers in the Dakotas. He is also actively involved in his family farming operation.

- Role of Derivatives Markets:

- Derivatives markets help farmers and agribusinesses manage commodity price risks.
- AG Tegra uses futures, options, and OTC derivatives to hedge price risks for grain, energy, and fertilizer.
- Current Market Conditions:
 - Agricultural markets are experiencing lower prices due to increased international crop production and favorable weather.
 - Example: December 2024 corn futures dropped from \$6.02/bushel in April 2022 to \$4.18 recently.
- Importance of the CFTC:
 - The CFTC ensures the integrity of commodity markets, essential for agriculture.
 - Despite expanded responsibilities, CFTC funding has remained flat.
- Funding Concerns:
 - Antonsen urges Congress to fund the CFTC sufficiently but opposes user fees on the industry.
 - User fees would increase costs for producers, discouraging hedging practices and increasing agricultural risk.
- Other Concerns:
 - Mentioned concerns about Basel III endgame proposals impacting capital requirements.
 - Encouraged Congress to repurpose these requirements.
- Conclusion:
 - Emphasized the need for effective hedging tools to support the viability of farmers.

Alexandra Thornton highlighted the CFTC's essential role in overseeing agricultural, physical commodities, and swap markets. She emphasized the CFTC's underfunding and the resulting limitations in fulfilling its mission.

- Current Challenges:
 - Underfunding prevented the CFTC from performing essential functions like comprehensive rule reviews and enforcement of advertising and fee rules.
 - The derivatives markets had become larger and more interconnected, increasing the CFTC's responsibilities.
- Need for Adequate Funding:
 - She advocated for reauthorizing and adequately funding the CFTC to maintain market integrity and prevent financial instability.
- Concerns with Expanding CFTC's Role:

- Thornton opposed expanding the CFTC's jurisdiction to new areas like digital assets and voluntary carbon credits due to existing underfunding and complexity.
- She highlighted rampant fraud in the crypto industry and the need for comprehensive regulatory frameworks to protect retail investors.
- She warned that developing a new regulatory framework for digital assets would be time-consuming, costly, and could introduce more uncertainty.
- Arguments Against a New Crypto Regulatory Regime:
 - A new CFTC regime could have duplicated the SEC's existing robust investor protection framework, leading to inefficiencies.
 - Such a regime could have incentivized securities market players to exploit weaker regulations, increasing risk to retail investors.
 - Creating a new regime could have misled investors about the safety of crypto investments.
- Voluntary Carbon Credits:
 - Thornton advised against authorizing the CFTC to regulate voluntary carbon credit derivatives due to the unreliable nature of the underlying assets.
 - She suggested that the market for carbon credits lacked sufficient transparency and reliability for effective regulation by the CFTC.
- Conclusion:
 - She recommended focusing on strengthening the CFTC's current responsibilities before considering expanding its role.

Questions and Answers:

[Rep. Frank Lucas \(R-OK\)](#) asked if Walter Lukken could expand on why it is so important that the regulators reopen their proposal for public comments.

Lukken praised Congressman Lucas and the Committee for highlighting that markets and central counterparties reduce financial risk, as evidenced by the financial crisis. He emphasized the importance of capital requirements for risky activities but criticized Prudential regulators for overburdening clearing activities. This over-taxation could limit banks' ability to offer hedging services, affecting end users like farmers. Lukken expressed hope that regulators would heed reasonable voices, like those of the CFTC, to appropriately adjust capital requirements in proportion to market risks.

Rep. Frank Lucas (R-OK) questioned Thomas Sexton about the importance of stakeholder feedback on capital rules impacting derivatives, highlighting their significance for farmers and end-users.

Sexton supported the idea of holding a roundtable to assess these impacts. Lucas then discussed the CFTC's enforcement authority, asking Walter Lukken whether the commission's cross-border authority is effective. Lukken affirmed that the CFTC has the appropriate authority to address misconduct with strong U.S. connections. Lucas concluded by emphasizing the critical need to address Basel capital requirements carefully to avoid severe economic damage.

Rep. Yadira Caraveo (D-CO) thanked the panel for their testimony on the CFTC reauthorization. She discussed previous efforts to harmonize enforcement authorities between the CFTC and SEC, specifically regarding fraud and manipulation outside the U.S., and sought opinions on whether such harmonization was appropriate.

Walter Lukken agreed that the CFTC needed clear authority to address misconduct overseas but was unsure if harmonizing with the SEC was the right approach. He noted that during his tenure, there were no impediments to tackling bad behavior abroad and that sharing information with foreign authorities was effective. Travis Antonsen also supported the need for robust CFTC authority.

Caraveo then inquired about concerns regarding conflicts of interest in vertically integrated structures, particularly where Futures Commission Merchants (FCMs) are owned by exchanges and clearing houses. Lukken expressed concerns about these structures, citing potential conflicts of interest and governance issues, as seen in the FTX case. He suggested the CFTC should investigate whether these structures require separation or additional governance. Antonsen agreed with Lukken's concerns but also noted that multiple FCMs can help mitigate these issues.

Rep. G.T. Thompson (R-PA) asked Walter Lukken about the evolution of the global derivatives markets since the last CFTC reauthorization in 2008. Lukken noted that the markets had become much more global, with over-the-counter derivatives presenting new challenges to CFTC authority. Despite these challenges, he believed the framework established by the Commodity Futures Modernization Act of 2000 had effectively kept pace with global growth, and there was no need for a major overhaul.

Thomas Sexton supported the reauthorization process, highlighting its importance in maintaining the CFTC's role in global derivatives markets and its adaptability to market changes.

Rep. G.T. Thompson then asked Travis Antonsen about the potential negative impacts of Basel III regulations on derivatives markets and end users. Antonsen expressed concerns that the regulations could lead to a reduction in the number of Futures Commission Merchants (FCMs), increasing hedging costs and limiting options for end users.

Walter Lukken agreed with Antonsen, emphasizing that reducing the number of FCMs would limit market access and potentially make the system less safe. He stressed the importance of addressing these issues to ensure a broad and healthy FCM system.

Rep. Jim Costa (D-CA) focused on the CFTC's funding issues. He asked Walter Lukken about the implications of a previous proposal to charge registration fees and the impact of a recent \$20 million budget cut.

Lukken supported adequate funding for the CFTC but expressed concerns about user fees potentially reducing hedging capabilities. Costa then asked if the lack of reauthorization since 2008 affected current funding challenges. Thomas Sexton explained the CFTC's funding sources and mentioned that new responsibilities would require additional resources, which would be managed through membership dues and fees.

Costa also inquired about the extent of crypto fraud and measures to combat it. Alexandra Thornton described the problem as significant and noted that unlike securities platforms, crypto platforms lack a national market system to ensure price transparency. Costa concluded by expressing interest in further exploring prudence and risk measurement.

Rep. Max Miller (R-OH) thanked the witnesses and discussed the importance of derivatives in managing agricultural risk, given the volatility in commodity markets. He asked how vital derivative products are to operations and whether the CFTC can effectively address and prevent harm from bad actors in the industry.

Travis Antonsen highlighted that derivatives are essential for managing risk, especially amid high volatility. Thomas Sexton assured that the NFA and CFTC's Division of Enforcement work closely to address bad actors.

Miller then asked about tools to withstand global uncertainties in commodities markets. Antonsen explained that derivatives help bridge gaps between producers and end users amidst market volatility. Miller concluded by suggesting that holding parties accountable in trade disputes could also help.

Rep. Tracey Mann (R-KS) expressed gratitude for the hearing and emphasized the importance of addressing agricultural risk management. He first asked Walter Lukken about potential gaps in the CFTC's authority to address overseas fraud affecting U.S. markets. Lukken noted that while the CFTC has the authority to tackle such issues with a U.S. nexus, the agency should not be expected to police global markets entirely.

Mann then inquired about a court case challenging how customer property is defined under the Commodity Exchange Act versus the U.S. Bankruptcy Code. Thomas Sexton explained that the issue involves ensuring customer funds are protected during FCM bankruptcies and that regulatory clarity is crucial for safeguarding customer assets.

Finally, Mann asked Lukken about the importance of global regulatory coordination. Lukken highlighted that sharing information and personnel between global regulators is vital for effective market oversight and that such practices were beneficial during his tenure.

Rep. Dusty Johnson (R-S.D.) questioned Alexandra Thornton about the jurisdiction over fraud and manipulation in commodity markets and derivatives, confirming that the CFTC has jurisdiction over both.

Thornton acknowledged the CFTC's role in regulating Bitcoin, which is not classified as a security by the SEC. Johnson criticized Thornton's view that creating a new regulatory regime would be problematic, asserting that the CFTC already effectively manages digital assets and commodities.

Rep. Johnson then asked Travis Antonsen about how CFTC reauthorization would serve as a vote of confidence. Antonsen explained that it would assure market participants of a stable and efficient regulatory environment. Walter Lukken and Thomas Sexton agreed that reauthorization would reinforce the CFTC's critical role both domestically and internationally.

Rep. Zach Nunn (R-Iowa) emphasized the CFTC's crucial role in regulating digital assets and praised its effectiveness in maintaining strong and resilient markets. He highlighted the importance of the CFTC's whistleblower program, which recently led to a \$55 million fine and expressed concern about its potential funding issues. Nunn proposed HR 4935 to ensure the program's continuity and sought commitment from panel members to support it.

He also expressed concerns about regulatory red tape affecting farmers, stressing the need for efficient CFTC operations without burdensome regulations. Travis Antonsen agreed that the current regulatory environment is effective but cautioned about potential future challenges. Nunn underscored the importance of keeping regulations manageable to avoid additional costs for farmers.